cushion. This will lower the risk that they face and continually reinforce their financial position. Competitors, who have no such cushion, will be at a disadvantage.

3. Current Law Does Not Support the Claim for Revenue Replacement and Compensation for Stranded Investment

The version of the regulatory compact between stockholders and ratepayers that LECs invoke to make their claims for stranded cost recovery never existed.[33] The guarantee of recovery that LECs claim is an ex post effort to recover assets and recoup actions for which management bears responsibility and stockholders have already been handsomely compensated.

To compensate companies for uneconomic investments, when they have already been compensated for the risk of those investments, constitutes a double recovery of costs which violates the fundamental principles of just and reasonable rates. Far from guaranteeing this complete recovery of all costs rendered uneconomic by competition, current law places the burden of the risk of competition squarely on the shoulders of utilities and shields them, at best, only from the most dire financial outcome -- bankruptcy. The extremely strong financial performance of local exchange companies undermines any claims that failure to recover obsolete and uneconomic investment will threaten the financial soundness of these companies.

4. Exposure to Risk is Not a Taking

Another problem with the LEC taking claims, as described in federal proceedings, is that they readily admit that there is not a taking at all in any direct sense, only a reallocation of risk. The assertion that the pricing scheme contemplated by the FCC would take their property rests on the claim that they would not be able to alter their prices for non-core services in the

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[33]GTE, Oklahoma, "Universal Service...," p. 24, SWBT, Oklahoma, p. 24.

marketplace to recover those costs.[34] This is absolutely not certain. To the extent that they are more efficient or more effective competitors, they will retain customers and there cannot possibly be a taking.

> With ILEC rates set at incremental cost, to the extent that market conditions preclude raising other prices, ILEC revenues and earnings will decline.[35]

The argument being made by the LECs about the marketplace assumes that the entrants do not have joint and common costs of their own. If the entrants do have joint and common costs, which they most certainly would, then the LECs will be able to recover their common costs. To the extent entrants have lower joint and common costs, the LEC should not recover its excess costs.[36]

5. New Opportunities Offset New Risks

As noted above, in the context of the federal legislation, it should also be recognized that there are important up-side opportunities for the LECs to enter new markets. Many of these markets can be served with the facilities that have been deployed to serve the local exchange market. For regulators to recognize only the down-side potential but not the up-side would bestow all the benefits on the companies while imposing all the costs on ratepayers. The exposure to risk in their current businesses is more than offset by the opportunity of revenue in the businesses which will be opened to them. The LECs repeatedly state that entry into long

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[34]We maintain that there is no economic need for rate rebalancing for universal services. In fact, permitting rate rebalancing would be extremely anti-competitive and anti-consumer.

[35]SBC, p. 91. (emphasis added)

[36]Ameritech clearly recognizes that its competitive entrants will have common costs. Ameritech p.67.

distance is a strong incentive to negotiate in good faith.[37] This strong incentive is a profit and revenue opportunity. Even if they were to lose some revenue in their current lines of business, above and beyond the billions of excess built-in, they could more than make up those revenues in the businesses opened up to them. No statement better summarizes the vast opportunities opened to the LECs than the following from its trade association

> The passage of the Act offers additional opportunities for many new market entrants. Specifically, it breaks down regulatory barriers and opens up local telephone, long-distance service and cable television to competition, thereby eliminating many of the restrictions that have prevented telephone companies, long-distance carriers and cable and utility companies from competing with each other. IXCs, cable television companies, RBOCs, and new entrants in the telecommunications marketplace all stand to gain a great deal from the provisions in the new Act. Specifically, the Act removes the ban that prohibited the RBOCs from entering the interstate market that was essentially dominated by AT&T, MCI and Sprint.[38]

6. Takings Claims under Regulation Involves Outcomes, Affecting the Overall Rate of Return, not Cost Categories or Even Specific Assets

The case law that the LECs frequently cite to attempt to dissuade the Commission from adopting a pro-competitive pricing approach to network elements makes it clear that takings involve only the most dire of outcomes.[39] The Supreme Court held that the overall result of the regulatory process had to be a rate of return that in the aggregate was confiscatory. The specific treatment of even specific assets, not to mention amorphous categories of cost, is not the basis for a takings claim. There is no constitutional guarantee of recovery of all costs, even when

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[37]USTA, p. 6; SBC p. 11.

[38]USTA, P. 89.

[39]USTA, Local Competition.

they are prudently incurred, there is only a guarantee of the opportunity to earn a rate of return that is not so low as to be confiscatory.

The constitutionality of a takings argument that rests on an entirely uncertain argument about the relative efficiencies of competitors in the market, how competitors will allocate and recover their joint and common costs, and where every new risk is offset by a profit opportunity is dubious at best. It is certainly not a basis for failing to implement the pro-competitive policy that Congress clearly had in mind when it passed the 1996 Act.

C. CONCLUSION

After the Commission has purged the revenue requirement of the companies of these illegitimate costs and allocated joint and common costs reasonably between services, it will find that redesign of rates is not necessary. The universal service fund mechanism at the federal level, combined with a state level universal service fund should be more than adequate to handle any targeted subsidies for high cost areas, low income households, and consumers with disabilities.